SECURITIES AND EXCHANGE COMMISSION
450 5th Street
Washington, D.C. 20549

FORM 8-K

CURRENT REPORT

Pursuant to Section 13 or 15(d) of the Securities
Exchange Act of 1934

Date of Report: March 9, 1995

Date of Earliest
Event Reported: March 9, 1995

AMERICA ONLINE, INC.
(Exact name of registrant as specified in its charter)

Delaware	0-19836	54-1322110
(State of incorporation or organization)	(Commission File Number)	(IRS Employer Identification No.)

8619 Westwood Center Drive, Vienna, Virginia	22182-2285
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number, including area code: (703) 448-8700

Item 5. Other Events.

Effective August 19, 1994, the Registrant acquired Redgate Communications Corporation ("Redgate") in a stock for stock merger (the "Merger"), as a result of which Redgate became a wholly owned subsidiary of the Registrant. The Merger was accounted for as a pooling of interests.

The Registrant previously filed all required financial statements, pro forma financial information and exhibits with the Securities and Exchange Commission as part of its Registration Statement on Form S-4 (Registration No. 33-82030) filed in connection with the Merger. Filed as part of this Current Report on Form 8-K are the financial statements of the Registrant that have been restated and combined to reflect the transaction for the periods indicated.

Item 7. Financial Statements and Exhibits.

(a) Consolidated Financial Statements of America Online, Inc. as of June 30, 1994 and 1993 and for the three years ended June 30, 1994 to reflect the acquisition of Redgate on August 19, 1994, accounted for using the pooling of interests method.

Selected Financial Data to reflect the acquisition of Redgate on August 19, 1994, accounted for using the pooling of interests method.

Management's Discussion and Analysis of Financial Condition and Reults of Operations to reflect the acquisition of Redgate on August 19, 1994, accounted for using the pooling of interests method.

(c) Exhibits.

23.1 Consent of Ernst & Young LLP.

Board of Directors and Stockholders
America Online, Inc.

We have audited the accompanying consolidated balance sheets of America Online, Inc. and subsidiaries as of June 30, 1994 and 1993, and the related consolidated statements of income, stockholders' equity and cash flows for each of the three years in the period ended June 30, 1994. The consolidated financial statements give retroactive effect to the merger of America Online, Inc. and Redgate Communications Corporation on August 19, 1994, which has been accounted for using the pooling of interests method as described in the notes to the consolidated financial statements. These financial statements are the responsibility of the management of America Online, Inc. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of America Online, Inc. and subsidiaries at June 30, 1994 and 1993, and the consolidated results of its operations and its cash flows for each of the three years in the period ended June 30, 1994, after giving retroactive effect to the merger of Redgate Communications Corporation, as described in the notes to the consolidated financial statements, in conformity with generally accepted accounting principles.

As discussed in Note 10 to the financial statements, in fiscal 1994 the Company changed its method of accounting for income taxes.

Ernst & Young LLP

Vienna, Virginia
September 9, 1994
except for Note 14, as to which the date is
November 25, 1994

America Online, Inc.
Consolidated Statements of Income
(In thousands, except per share data)

	Year Ended June 30, 1994	1993	1992
Revenues:			
Online service revenues	$ 100,993	$ 38,462	$ 26,226
Other revenues	14,729	13,522	12,527
Total revenues	115,722	51,984	38,753
Costs and expenses:			
Cost of revenues	69,043	28,820	20,852
Marketing	23,548	9,745	5,747
Product development	4,961	2,913	2,015
General and administrative	13,562	8,581	6,454
Total costs and expenses	111,114	50,059	35,068
Income from operations	4,608	1,925	3,685
Other income, net	1,774	371	113
Income before provision for income taxes and extraordinary item	6,382	2,296	3,798
Provision for income taxes	(3,832)	(1,897)	(1,454)
Income before extraordinary item	2,550	399	2,344
Extraordinary item - tax benefit arising from net operating loss carryforward	-	1,133	1,424
Net income	$ 2,550	$ 1,532	$ 3,768
Earnings per share:			
Income before extraordinary item			
Primary	$ 0.15	$ 0.03	$ 0.23
Fully diluted	$ 0.15	$ 0.03	$ 0.21
Net income			
Primary	$ 0.15	$ 0.11	$ 0.37
Fully diluted	$ 0.15	$ 0.10	$ 0.33
Weighted average common and common equivalent shares:			
Primary	17,014	14,094	10,158
Fully diluted	17,104	14,643	11,414

See accompanying notes.

America Online, Inc.
Consolidated Balance Sheets
(Dollars in thousands)

	June 30, 1994	June 30, 1993
ASSETS		
Current assets:		
Cash and cash equivalents	43,891	$ 10,163
Short-term investments	24,052	5,105
Trade accounts receivable	8,547	4,281
Receivables from affiliate	1,466	921
Other receivables	570	434
Prepaid expenses and other current assets	5,753	2,886
Deferred subscriber acquisition costs	25,459	6,521
Total current assets	109,738	30,311
Property and equipment at cost, net	20,306	4,368
Other assets:		
Product development costs, net	7,912	3,915
Deferred subscriber acquisition costs, net	933	369
Licenses rights, net	53	35
Other assets	2,800	281
Deferred income taxes	12,842	-
	$ 154,584	$ 39,279
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Trade accounts payable	$ 15,642	$ 5,438
Accrued personnel costs	896	529
Other accrued expenses and liabilities	13,076	3,550
Deferred revenue	4,488	2,166
Notes payable	253	1,316
Line of credit	1,690	-
Current portion of long-term debt and capital lease obligations	344	293
Deferred income taxes	9,610	759
Total current liabilities	45,999	14,051
Capital lease obligations	1,179	1,301
Notes payable	5,836	49
Deferred rent	41	93
Deferred income taxes	3,232	-
Stockholders' equity:		
Preferred stock, $.01 par value; 5,000,000 shares authorized, none issued	-	-
Common stock, $.01 par value; 20,000,000 shares authorized, 15,385,606 and 12,390,534 shares issued and outstanding at June 30, 1994 and 1993, respectively	154	124
Additional paid-in-capital	98,990	27,058
Accumulated deficit	(847)	(3,397)
Total stockholders' equity	98,297	23,785
	$ 154,584	$ 39,279

See accompanying notes.

America Online, Inc.
Consolidated Statements of Changes in Stockholders' Equity (Deficiency)
(In thousands, except share data)

	Common Stock Shares	Common Stock Amount	Accrued Dividends in Excess of Retained Earnings	Additional Paid-In Capital	Accumulated Deficit	Total
Balances at June 30, 1991	2,870,524	$ 28	$ (2,403)	$ 2,461	$ (8,709)	$ (8,623)
Pooling of interest - RCC	-	-	-	-	71	71
Exercise of common stock options and warrants	446,164	4	-	268	-	272
Accretion of dividends	-	-	(232)	-	-	(232)
Sale of common stock, net	2,200,186	22	-	12,037	-	12,059
Conversion of convertible redeemable preferred stock into common stock	6,051,016	62	2,635	11,585		14,282
Tax benefit related to stock options				14	-	14
Net income	-	-	-	-	3,768	3,768
Balances at June 30, 1992	11,567,890	116	-	26,365	(4,870)	21,611
Exercise of common stock options and warrants	822,644	8	-	576	-	584
Other	-	-	-	111	(59)	52
Tax benefit related to stock options	-	-	-	6	-	6
Net income	-	-	-	-	1,532	1,532
Balances at June 30, 1993	12,390,534	124	-	27,058	(3,397)	23,785
Exercise of common stock options and warrants	706,820	7	-	1,857	-	1,864
Sale of common stock, net	2,288,252	23	-	65,485	-	65,508
Tax benefit related to stock options	-	-	-	4,590	-	4,590
Net income	-	-	-	-	2,550	2,550
Balances at June 30, 1994	15,385,606	$ 154	$ -	$ 98,990	$ (847)	$ 98,297

See accompanying notes.

America Online, Inc.
Consolidated Statements of Cash Flows
(In thousands, except per share data)

	Year ended June 30, 1994	1993	1992
Cash flows from operating activities:			
Net income	$ 2,550	1,532	3,768
Adjustments to reconcile net income to net			
Cash provided by operating activities:			
Depreciation and amortization	2,965	1,957	1,393
Amortization of subscriber acquisition costs	17,922	7,038	3,991
(Gain)/Loss on sale of property and equipment	5	(39)	40
Changes in assets and liabilities:			
Trade accounts receivable	(4,266)	(936)	(668)
Receivables from affiliate	(545)	(921)	-
Other receivables	(136)	(45)	(185)
Prepaid expenses and other current assets	(2,867)	(1,494)	(94)
Other assets	(2,519)	(89)	34
Trade accounts payable	10,204	2,119	6
Accrued personnel costs	367	336	97
Other accrued expenses and liabilities	9,526	1,492	693
Deferred revenue	2,322	1,381	382
Deferred income taxes	3,832	759	-
Deferred rent	(52)	(200)	(165)
Total adjustments	36,758	11,358	5,524
Net cash provided by operating activities	39,308	12,890	9,292
Cash flows from investing activities:			
Short-term investments	(18,947)	(5,105)	85
Purchase of property and equipment	(17,886)	(2,041)	(968)
Product development costs	(5,132)	(1,831)	(952)
Sale of property and equipment	95	62	-
Subscriber acquisition costs	(37,424)	(10,685)	(5,567)
Net cash used in investing activities	(79,294)	(19,600)	(7,402)
Cash flows from financing activities:			
Proceeds from issuance of common stock, net	67,372	609	15,128
Principle and accrued interest payments on revolving line of credit and long-term debt	(7,716)	(6,976)	(8,277)
Proceeds from revolving line of credit and issuance of long-term debt	14,200	7,181	7,490
Payment of dividends on convertible redeemable preferred stock, net	-	-	(3,199)
Tax benefit from stock option exercises	-	6	14
Principal payments under capital lease obligations	(142)	(112)	(124)
Net payments on revolving line of credit	-	52	-
Net cash provided by financing activities	73,714	760	11,032
Net increase (decrease) in cash and cash equivalents	33,728	(5,950)	12,922
Cash and cash equivalents at beginning of period	10,163	16,113	1,361
Cash and cash equivalents at end of period	$ 43,891	$ 10,163	14,283
Supplemental cash flow information			
Cash paid during the period for:			
Interest	575	193	195
Income taxes	-	15	65

The Consolidated

See accompanying notes.

AMERICA ONLINE, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Organization

America Online, Inc. and subsidiaries (the Company), was incorporated in the State of Delaware in May 1985. The Company, based in Vienna, Virginia, is a leading provider of online services, offering its subscribers a wide variety of services, including electronic mail, conferencing, software, computer support, interactive magazines and newspapers, and online classes, as well as easy and affordable access to services of the Internet.

2. Summary of Significant Accounting Policies

Principles of Consolidation-The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. All significant intercompany accounts and transactions have been eliminated.

Revenue and cost recognition—Online service revenue is recognized over the period services are provided. Other revenue, consisting principally of marketing services and outside development funding which is recognized as services are rendered. Deferred revenue consists principally of third-party development funding not yet recognized and monthly subscription fees billed in advance.

Property and equipment—Property and equipment are depreciated or amortized using the straight-line method over the estimated useful life of the assets, which range from 5 to 40 years, or over the life of the lease.

Property and equipment under capital leases is stated at the lower of the present value of minimum lease payments at the beginning of the lease term or fair value at inception of the lease.

Deferred subscriber acquisition costs—Subscriber acquisition costs are deferred and charged to operations over a twelve or eighteen month period (straight-line method) beginning the month after such costs are incurred. These costs, which relate directly to subscriber solicitations, principally include printing, production and shipping of starter kits and the costs of obtaining qualified prospects by various targeted direct marketing programs (i.e., direct marketing response cards, mailing lists) and from third parties are recorded separately from ordinary operating expenses. No indirect costs are included in subscriber acquisition costs. To date, all subscriber acquisition costs have been incurred for the solicitation of specific identifiable prospects. Costs incurred for other than those targeted at specific identifiable prospects for the Company's services, and general marketing, are expensed as incurred.

The Company's services are sold on a monthly subscription basis. Subscriber acquisition costs incurred to obtain new subscribers are recoverable from revenues generated by such subscribers within a short period of time after such costs are incurred.

Effective July 1, 1992, the Company changed the period over which it amortizes the cost of marketing acquisition costs relating to marketing activities in which the Company's starter kit is bundled with and distributed by a third-party marketing company from twelve months to eighteen months. The change in accounting estimate was made to more accurately match revenues and expenses. Based on the Company's experience and the distribution channels used in such marketing activities, there is a greater time lag between the time the Company incurs the cost for the starter kits and the time the starter kits begin to generate new customers than with direct marketing activities. Also, the period over which new subscribers (and related revenues) are generated is longer than that experienced with the use of traditional independent, direct marketing activities. The effect of this change in accounting estimate for the year ended June 30, 1993 was to increase income before extraordinary item and net income by $264,000 ($.02 per share).

In the first quarter of fiscal 1995 the Company is required to adopt the provisions of Statement of Position (SOP) 93-7 "Reporting on Advertising Costs" which provides guidance on financial reporting on advertising costs. As of June 30, 1994 the Company is in compliance with the provisions of the SOP.

Product development costs—The Company capitalizes costs incurred for the production of computer software used in the sale of its services. Costs capitalized include direct labor and related overhead for software produced by the Company and the costs of software purchased from third parties. All costs in the software development process which are classified as research and development are expensed as incurred until technological feasibility has been established. Once technological feasibility has been established, such costs are capitalized until the software is commercially available. Amortization is provided on a product-by-product basis, using the greater of the straight-line method or current year revenue as a percent of total revenue estimates for the related software product not to exceed five years, commencing the month after the date of product release.

Product development costs consist of the following:

	Year ended June 30,	
	1994	**1993**
(in thousands)		
Balance, beginning of year	**$3,915**	$2,876
Costs capitalized	**5,132**	1,831
Costs amortized	**(1,135)**	(792)
Balance, end of year	**$7,912**	$3,915

The accumulated amortization of product development costs related to the production of computer software totaled $5,885,000, and $4,750,000 at June 30, 1994 and 1993, respectively.

Included in product development costs are research and development costs totaling $2,126,000, $1,130,000, and $698,000 and other product development costs totaling $1,050,000, $579,000 and $681,000 in the years ended June 30, 1994, 1993 and 1992, respectively.

License rights—The cost of acquired license rights is amortized using the straight-line method over the term of the agreement for such license rights.

Operating lease costs—Rent expense for operating leases is recognized on a straight-line basis over the lease term. The difference between rent expense incurred and rental payments is charged or credited to deferred rent.

Cash, cash equivalents and short-term investment—The Company considers all highly liquid investment instruments with an original maturity of three months or less to be cash equivalents. Similar investments with original maturities beyond three months are considered short-term investments and are carried at cost plus accrued interest, which approximates market value.

In the first quarter of fiscal 1995 the Company is required to adopt the provisions of Financial Accounting Standards Board Statement 115 "Accounting for Investments in Certain Debt and Equity Securities" (FAS 115). FAS 115 requires companies to present investments in marketable equity securities and many debt securities at fair value as opposed to historical cost accounting. The adoption of FAS 115 is not expected to have a material impact in the company's financial position or results of operations.

Net income per common share—Earnings per share (EPS) are calculated by dividing income before extraordinary item and net income by the weighted average number of common and common equivalent shares outstanding during the period. For primary EPS, common equivalent shares are shares which would be issuable upon the exercise of outstanding stock options and warrants, reduced by the number of shares assumed purchased by the Company with the resulting proceeds at the average market price during the period. For the fully diluted EPS calculation, shares are assumed to be purchased by the Company at the higher of the average or period-end market price and, therefore, this calculation may include additional equivalent shares. In the fiscal 1992 calculation of primary EPS, income before extraordinary item and net income have been reduced by $232,000 to reflect accrued dividends on convertible redeemable preferred stock.

Reclassification—Certain amounts in the 1993 financial statements have been reclassified to conform to the 1994 presentation.

3. Acquisitions

On August 19, 1994, Redgate Communications Corporation ("RCC") was merged with and into a subsidiary of the Company. 894,650 shares of AOL's common stock were issued in exchange for all of the outstanding common and preferred stock and warrants of RCC. Additionally, 200,574 shares of AOL's common stock was reserved for outstanding stock options issued by RCC and being assumed by AOL. The merger was accounted for as a pooling of interests, and accordingly, the accompanying consolidated financial statements have been restated for all periods prior to the acquisition to include the results of operations, financial positions and cash flows of RCC.

Net sales and net earnings for the individual entities are as follows:

	Year ended June 30		
	1994	**1993**	**1992**
Total revenues:			
AOL	**$ 104,410**	$ 40,019	$ 26,591
RCC	**11,312**	11,965	12,162
	$ 115,722	$ 51,984	$ 38,753
Net income:			
AOL	**$ 6,210**	$ 4,210	$ 3,538
RCC	**(3,660)**	(2,678)	230
	$ 2,550	$ 1,532	$ 3,768

In connection with the merger of AOL and RCC, $1,710,000 of merger expenses were recognized and have been charged to merger expenses during fiscal year 1995.

The consolidated financial statements for all years prior to the merger have been restated to include RCC's results for the twelve months ended June 30. Effective August 1994, RCC's fiscal year-end has been changed from December 31 to June 30 to conform to AOL's fiscal year end. The Company's 1992 financial statements reflect the accounts of RCC for the twelve months ended December 31, 1991. Accordingly, RCC's operations for the six months ended June 30, 1992, including revenues of approximately $5,101,000 and net income of approximately $71,000 have been excluded from the combined results and have been reported as an adjustment to the July 1, 1991, consolidated retained earnings.

4. Property and Equipment

Property and equipment consist of the following:

(in thousands)	1994	June 30, 1993
Computer equipment	$ 12,418	$ 4,364
Furniture and fixtures	1,398	1,026
Building	5,648	-
Land	2,052	-
Building improvements	1,343	-
Property under capital leases	2,686	2,523
Leasehold improvements	306	301
	25,851	8,214
Less accumulated depreciation and amortization	5,545	3,846
Net property and equipment	$ 20,306	$ 4,368

5. License Rights

License rights consist of the following:

(in thousands)	June 30, 1994	1993
License rights	$ 954	$ 863
Less accumulated amortization	901	828
	$ 53	$ 35

6. Commitments

The Company leases equipment under several long-term capital and operating leases. Future minimum payments under capital leases and noncancelable operating leases with initial terms of one year or more consist of the following:

(in thousands)	Capital Leases	Operating Leases
Year ending June 30,		
1995	$ 332	$ 2,647
1996	326	2,427
1997	321	2,091
1998	320	892
Thereafter	519	0
Total minimum lease payments	$ 1,818	$ 8,057
Less amount representing interest	343	
Present value of net minimum capital lease payments, including current portion of $296	$1,475	

The Company's rental expense under operating leases in 1994, 1993 and 1992 totaled approximately $2,889,000, $2,155,000, and $1,946,000, respectively.

Communication networks—The Company has guaranteed monthly usage levels of data and voice communications with its vendors. The remaining commitments are $42,200,000, $40,400,000, $28,500,000, $22,500,000 and $15,750,000 for the years ending June 30, 1995, 1996, 1997, 1998 and 1999, respectively. The related expense for the years ended June 30, 1994, 1993 and 1992 was $40,315,000, $11,226,000 and $7,019,999, respectively.

7. Other Revenues

Other revenues include payments received from various third parties, including Apple Computer, Inc. (Apple), for certain product and marketing development activities conducted by the Company.

In December 1992 the Company entered into a seven-year licensing and development agreement (with renewal provisions to extend the agreement through November 30, 2004) with Apple. Under the agreement, the Company granted Apple a non-exclusive license to use the America Online services platform to provide Apple-branded online services, and agreed to provide development services to Apple on a fee for services basis. The Company will receive a royalty based on usage, with a total minimum royalty of $15 million over a five year period following the commercial launch of the Apple-branded online service. In addition to royalties, the Company received development funding leading up to the commercial launch of the Apple-branded online service. Apple commercially launched its branded online service, called e-World, in June 1994. A total of $2,957,000 and $1,548,000 of development funding has been recognized in the years ended June 30, 1994 and 1993, respectively, of which $1,466,000 and $921,000 is receivable at June 30, 1994 and 1993, respectively.

8. Line of Credit and Notes Payable

At June 30, 1994, the Company had a revolving line of credit with its bank. The line was paid during August 1994.

Notes payable at June 30, 1994 consist primarily of an amount borrowed to finance the purchase of the office building in which the Company's offices are located. The note is collateralized by the Company's office building and carries interest at a variable interest rate equal to 105 basis points above the 30 day London Interbank Offered Rate. The note amortizes on a straight-line basis over a term of 25 years. The note provides for monthly principal payments of $21,067, plus accrued interest, for the next five years.

9. Other Income

The following table summarizes the components of other income reflected in the accompanying consolidated statements of income:

	Year ended June 30,		
(in thousands)	**1994**	**1993**	**1992**
Interest income	**$ 1,646**	$ 572	$ 317
Interest expense	**(575)**	(172)	(158)
Other	**703**	(29)	(46)
Other income	**$ 1,774**	$ 371	$ 113

10. Income Taxes

The provision for income taxes is attributable to:

(in thousands)	Year ended June 30, 1994	1993	1992
Income before extraordinary item	$ 3,832	$ 1,897	$ 1,454
Tax benefit arising from net operating loss carryforward	-	(1,133)	(1,424)
	$ 3,832	$ 764	$ 30
Current	$ -	$ 5	$ 30
Deferred	3,832	759	-
	$ 3,832	$ 764	$ 30

The provision for income taxes differs from the amount computed by applying the statutory federal income tax rate to income before provision for income taxes and extraordinary item. The sources and tax effects of the differences are as follows:

(in thousands)	Year ended June 30, 1994	1993	1992
Income tax at the federal statutory rate of 34%	$ 2,170	$ 781	$ 1,291
Losses relating to RCC	1,259	916	-
State income tax, net of federal benefit	403	200	163
	$ 3,832	$1,897	$ 1,454

Deferred income taxes arise because of differences in the treatment of income and expense items for financial reporting and income tax purposes, primarily relating to subscriber acquisition and product development costs.

As of June 30, 1994, the Company had available a net operating loss carryforward of approximately $46,100,000 for tax purposes which will be available, subject to certain annual limitations, to offset future taxable income. If not used, these loss carryforwards will expire between 2001 and 2009. The Company's net operating loss carryforward includes cumulative deductions of $24,380,000 relating to stockholders' equity. To the extent that net operating loss carryforwards, when realized, relate to these deductions, the resulting benefits will be credited to stockholders' equity.

The Company's income tax provision was computed based on the federal statutory rate and the average state statutory rates, net of the related federal benefit.

Effective July 1, 1993 the Company changed its method of accounting for income taxes from the deferred method to the liability method required by FASB Statement No. 109, "Accounting for Income Taxes." As permitted under the new rules, prior years' financial statements have not been restated.

No increase to net income resulted from the cumulative effect of adopting Statement 109 as of July 1, 1993. The deferred tax asset increased by approximately $5,965,000 as a result of the adoption. Similarly, the deferred tax liability, stockholders' equity and the valuation allowance increased by approximately $3,173,000, $759,000 and $2,033,000 respectively.

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Significant components of the Company's deferred tax liabilities and assets as of June 30, 1994 are as follows:

Deferred tax liabilities:	
Capitalized software costs	$ 2,962,000
Deferred member acquisition costs	9,880,000
Net deferred tax liabilities	$12,842,000
Deferred tax assets:	
Net operating loss carryforwards	$17,510,000
Total deferred tax assets	17,510,000
Valuation allowance for deferred assets	(4,668,000)
Net deferred tax assets	$12,842,000

11. Capital Accounts

Common stock—At June 30, 1994 and 1993, the Company's $.01 par value common stock authorized was 20,000,000 shares, with 15,385,606, and 12,390,534 shares issued and outstanding, respectively. At June 30, 1994, 6,907,536 shares were reserved for the exercise of issued and unissued common stock options and warrants, and 170,394 shares were reserved for issuance in connection with the Company's Employee Stock Purchase Plan.

Preferred stock—At June 30, 1991 the Company was authorized to issue 1,191,785 shares of $1.00 par value convertible redeemable preferred stock, of which 356,790, 331,785 and 500,000 were issued and outstanding as Series A, B, and C, respectively. In September 1991, the Company authorized and issued 255,964 shares of $1.00 par value Series D convertible redeemable preferred stock. In connection with the closing of the Company's initial public offering on March 26, 1992, all series of preferred stock converted to common stock and the Company paid dividends of $3,199,000 to holders of the Series A, B, and C convertible redeemable preferred stock.

In February 1992, the Company's stockholders approved an amendment and restatement of the certificate of incorporation which authorized the future issuance of 5,000,000 shares of preferred stock, $.01 par value, with rights and preferences to be determined by the Board of Directors. As of June 30, 1994 no shares of preferred had been issued.

Warrants—Under a December 1992 agreement with Apple (see Note 7) the Company issued warrants to Apple to purchase 1,000,000 shares of America Online common stock at an exercise price of $12.50 per share.

In connection with an agreement with the Company's primary communications provider, the Company issued warrants, exercisable through March 31, 1999, to purchase 900,000 shares of America Online common stock at a price of $15.625 per share.

Shareholder Rights Plan—During fiscal 1993 the Company adopted a shareholder rights plan and distributed a dividend of one preferred share purchase right (a "Right") for each outstanding share of America Online's common stock. The Rights become exercisable in certain limited circumstances involving a potential business combination or change of control transaction of the Company. Each Right initially entitles registered holders of the Company's common stock to purchase one one-hundredth of a share of the Company's new Series A Junior Participating Preferred Stock ("Series A Preferred Stock") at a price of $150.00 per one one-hundredth of a share of Series A Preferred Stock. Following certain other events after the Rights have become exercisable, each Right entitles its holder to purchase for $150.00 an amount of common stock of the Company or, in certain circumstances, securities of the acquirer, having a then-current market value of two times the exercise price of the Right. The Rights are redeemable for one cent per right at the option of the Board of Directors. Until a Right is exercised, the holder of the Right , as such, has no rights as a shareholder of the Company. The Rights expire on May 3, 2003 unless redeemed prior to that date.

12. Stock Plans

Incentive stock option plan—In June 1985, the Company approved and adopted an incentive stock option plan (the 1985 Plan). The 1985 Plan provides for the grant of options to purchase common stock to eligible employees of the Company. The 1985 Plan is administered by the Stock Compensation Committee of the Board of Directors. The 1985 Plan will terminate in December 1995. The total number of shares of common stock that may be issued pursuant to options granted under the 1985 Plan is 1,501,436. The issued options vest over three-year or four-year periods and are exercisable for ten years following the date of the grant.

The following table summarizes incentive stock option activity under the 1985 Plan:

	Number of shares	Option price per share
Balance at June 30, 1991	928,680	$0.25 - $0.50
Granted	262,476	$1.75 - $4.50
Exercised	(92,270)	$0.25 - $0.50
Forfeited	(2,964)	$0.25 - $4.50
Balance at June 30, 1992	1,095,922	$0.25 - $4.50
Granted	-	-
Exercised	(201,618)	$0.25 - $4.50
Forfeited	(7,120)	$4.50
Balance at June 30, 1993	887,184	$0.25 - $4.50
Granted	-	-
Exercised	(235,108)	$0.25 - $4.50
Forfeited	(1,100)	$4.50
Balance at June 30, 1994	650,976	$0.25 - $4.50

At June 30, 1994, 520,372 options were exercisable. There have been 841,008 options exercised under the 1985 Plan.

Stock incentive plan—In December 1987, the Company's Board of Directors adopted a stock incentive plan (the 1987 Plan). The 1987 Plan provides for the grant of options to purchase common stock and awards of restricted common stock to employees and independent contractors of the Company. The 1987 Plan is administered by the Stock Compensation Committee of the Board of Directors. The total number of shares of common stock that may be issued pursuant to options granted under the 1987 Plan or pursuant to stock awards is 2,004,000. The issued options vest over three-, four- or five-year periods and are exercisable for ten years following the date of grant.

The following table summarizes stock incentive option activity under the 1987 Plan:

	Number of shares	Option price per share
Balance at June 30, 1991	1,740,800	$0.50 - $1.00
Granted	267,700	$1.00 - $4.50
Exercised	(331,894)	$0.50 - $1.00
Forfeited	(18,974)	$1.00 - $1.75
Balance at June 30, 1992	1,657,632	$0.50 - $4.50
Granted	-	-
Exercised	(556,714)	$0.50 - $4.50
Forfeited	(7,300)	$1.00
Balance at June 30, 1993	1,093,618	$0.50 - $4.50
Granted	-	-
Exercised	(363,812)	$0.50 - $4.50
Forfeited	-	-
Balance at June 30, 1994	729,806	$0.50 - $4.50

At June 30, 1994, 497,086 options were exercisable. There have been 1,256,420 options exercised under the 1987 Plan.

1992 Employee, Director and Consultant Stock Option Plan—In February 1992, the Company approved and adopted an employee, director and consultant stock option plan (the 1992 Plan). The 1992 Plan provides for the grant of either incentive stock options or non-qualified stock options. Incentive stock options may be granted under the 1992 Plan to employees of the Company and its affiliates. Non-qualified stock options may be granted to consultants, directors, employees or officers of the Company and its affiliates. The 1992 Plan provides for an annual grant to each non-employee director on November 1 of an option to purchase 10,000 shares of common stock at an exercise price equal to the fair market value of the Common Stock on such date and vesting in one year. The 1992 Plan is administered by the Stock Compensation Committee of the Board of Directors. The total number of shares that may be issued pursuant to options granted under the 1992 Plan is 5,020,000, which includes increases of 1,500,000 shares each, approved by the Board of Directors in January and July 1994, that are subject to approval by the stockholders of the Company at the annual stockholders meeting in October 1994. The issued options vest over one-, three-, or four-year periods and are exercisable for ten years following the date of grant.

	Number of shares	Option price per share
Balance at June 30, 1991	-	-
Granted	6,000	$7.12
Exercised	-	-
Forfeited	-	-
Balance at June 30, 1992	6,000	$7.12
Granted	1,607,700	$6.37 - $18.37
Exercised	-	-
Forfeited	(4,000)	$7.37
Balance at June 30, 1993	1,609,700	$6.37 - $18.37
Granted	729,300	$18.62 - $36.50
Exercised	(93,820)	$6.37 - $15.00
Forfeited	(53,600)	$6.37 - $36.00
Balance at June 30, 1994	2,191,580	$6.37 - $36.50

At June 30, 1994, 334,542 options were exercisable. There have been 93,820 options exercised under the 1992 Plan.

At June 30, 1994, the Company had 200,574 common stock options outstanding relating to options issued by RCC which were assumed by AOL. The options are exercisable at prices ranging from $6.65 to $13.30 and vest over the next three years. At June 30, 1994, 61,179 options were exercisable.

Employee Stock Purchase Plan—In May 1992, the Company's Board of Directors adopted an Employee Stock Purchase Plan (the ESPP). Under the ESPP, employees of the Company and its subsidiaries who elect to participate are granted options to purchase common stock at a 15 percent discount from the market value of such stock. The ESPP permits an enrolled employee to make contributions by having withheld from his or her salary an amount between 1 percent and 10 percent of compensation to purchase shares of common stock. The ESPP is administered by the Compensation Committee of the Board of Directors. The total number of shares of common stock that may be issued pursuant to options granted under the ESPP is 200,000. There were 14,080 and 15,526 shares of common stock issued under the ESPP in the years ended June 30, 1994 and 1993, respectively.

13. Employee Benefit Plan

Savings Plan— The Company has a savings plan (the Savings Plan) that qualifies as a deferred salary arrangement under Section 401(k) of the Internal Revenue Code. Under the Savings Plan , participating employees may defer a portion of their pretax earnings, up to the Internal Revenue Service annual contribution limit. The Company matches 50% of each employee's contributions up to a maximum of 4% of the employee's earnings. The Company's matching contribution to the Savings Plan was $168,448 and $23,600 in the years ended June 30, 1994 and 1993, respectively.

Other—In 1991, FASB issued SFAS No. 106, "Employers' Accounting for Post-Retirement Benefits Other Than Pension," which requires the cost of post-retirement benefits, other than pension benefits, to be recognized on an accrual basis. The Company does not provide employee benefits covered by SFAS No. 106. Accordingly, SFAS No. 106 does not have an effect on the Company's financial position or results of operations.

14. Events subsequent to the date of the independent auditor's report

Stock Split—On November 25, 1994, the Company effected a two-for-one split of the outstanding shares of common stock. Accordingly, all data shown in the accompanying consolidated financial statements and notes has been retroactively adjusted to reflect the stock split.

15. Events (unaudited) subsequent to the date of the independent auditor's report

Business Combinations:

Navisoft, Inc.

On November 30, 1994, Navisoft, Inc. ("Navisoft") was merged with and into a subsidiary of America Online, Inc. ("AOL") and 130,000 shares of AOL's common stock was issued in exchange for all of the outstanding common stock, preferred stock, options and warrants of Navisoft. Additionally, 22,583 shares of AOL's common stock was reserved for outstanding stock options issued by Navisoft and being assumed by AOL. The acquisition was accounted for under the purchase method, and accordingly, the assets and liabilities were recorded based on their fair values at the date of acquisition. Of the aggregate purchase price of approximately $6,610,000, $5,424,000 was allocated to in-process research and development and $957,000 was allocated to other intangible assets. The amount of the purchase price allocated to in-process research and development was charged to the Company's fiscal 1995 operations at the time of the acquisition.

Booklink Technologies, Inc.

On December 23, 1994, Booklink Technologies, Inc. ("Booklink") was merged with and into a subsidiary of America Online, Inc. ("AOL") and 710,000 shares of AOL's common stock was issued in exchange for all of the outstanding common stock of Booklink. Additionally, 128,912 shares of AOL's common stock was reserved for outstanding stock options issued by Booklink and being assumed by AOL. The acquisition was accounted for under the purchase method, and accordingly, the assets and liabilities were recorded based on their fair values at the date of acquisition. Of the aggregate purchase price of approximately $43,925,000, $37,361,000 was allocated to in-process research and development and $6,593,000 was allocated to other intangible assets. The amount of the purchase price allocated to in-process research and development was charged to the Company's fiscal 1995 operations at the time of the acquisition.

Advanced Network and Services, Inc.

On February 15, 1995, the Company acquired substantially all of the assets of Advanced Network & Services ("ANS"), including all of the stock of ANS+Core, its wholly-owned commercial subsidiary. The Company paid $37,501,000 for the acquisition, of which $19,759,000 was cash and

$17,742,000 was in common stock. The acquisition was accounted for under the purchase method, and accordingly, the assets and liabilities were recorded based on their fair values at the date of acquisition. Other purchase price allocations will be determined when the Company completes its in-process valuation.

Joint Venture:

Bertelsmann, AG

On March 1, 1995, the Company jointly announced with Bertelsmann, AG that they have signed a memorandum of understanding to offer interactive services in Europe. The two companies will form a joint venture with each owning 50%, with Bertelsmann, AG contributing approximately $100 million, and the Company contributing leadership in developing, managing, and executing interactive services, its technology, as well as access to its U.S. content and partners. In addition, Bertelsmann, AG will become a minority stockholder with approximately a 5% stake in the Company representing an investment of approximately $50 million.

Quarterly Information

	September 30	December 31	March 31	June 30	Total
Fiscal 1994					
Net service revenues	$ 14,299	$ 20,292	$ 28,853	$ 37,549	$ 100,993
Other revenues	4,780	4,239	2,836	2,874	14,729
Total revenues	19,079	24,531	31,689	40,423	115,722
Income from operations	531	520	1,931	1,626	4,608
Income before extraordinary item	303	70	1,272	905	2,550
Net income	303	70	1,272	905	2,550
Net income per share(i)	$ 0.02	$ -	$ 0.07	$ 0.05	$ 0.15
Fiscal 1993					
Net service revenues	$ 7,768	$ 9,015	$ 9,892	$ 11,787	$ 38,462
Other revenues	2,557	3,127	4,279	3,559	13,522
Total revenues	10,325	12,142	14,171	15,346	51,984
Income from operations	972	182	855	(84)	1,925
Income before extraordinary item	663	(176)	387	(475)	399
Net income	1,070	252	611	(401)	1,532
Net income per share(i)	$ 0.08	$ 0.02	$ 0.04	$ (0.03)	$ 0.10

(i) The sum of per-share earnings does not equal earnings per share for the year due to equivalent share calculations which are impacted by fluctuations in the Company's common stock market prices.

SELECTED FINANCIAL DATA

(amounts in thousands, except per share data)	1994	1993	1992	1991	1990
	YEAR ENDED JUNE 30,				
Consolidated Statement of Operations Data:					
Online service revenues	$100,993	$ 38,462	$ 26,226	$ 19,515	$ 17,343
Other revenues	14,729	13,522	12,527	10,646	8,262
Total revenues	115,722	51,984	38,753	30,161	25,605
Income from operations	4,608	1,925	3,685	1,341	(126)
Income before extraordinary item	2,550	399	2,344	1,100	(668)
Net income	2,550	1,532	3,768	1,761	(607)
Income per common share:					
Income before extraordinary item	$ 0.15	$ 0.03	$ 0.21	$ 0.11	$ 0.08
Net income	$ 0.15	$ 0.10	$ 0.33	$ 0.18	$ 0.07
Weighted average number of common and common equivalent shares outstanding	17,104	14,643	11,414	9,652	8,162
Consolidated Balance Sheet Data (at fiscal year end):					
Working capital	$ 63,739	$ 16,260	$ 15,606	$ 701	$ (1,355)
Total assets	154,584	39,279	31,144	11,534	10,802
Total debt	9,302	2,959	2,672	1,865	3,171
Stockholders' equity (deficiency)	98,297	23,785	20,612	(8,712)	(11,445)

The selected financial data for all years prior to the RCC merger have been restated to include RCC's results for the twelve months ended June 30. Effective August 1994, RCC's fiscal year-end has been changed from December 31 to June 30 to conform to AOL's fiscal year end. The Company's 1990, 1991 and 1992 financial statements reflect the accounts of RCC for the twelve month periods ended December 31, 1989, 1990 and 1991, respectively. Accordingly, RCC's operations for the six months ended June 30, 1992, including revenues of approximately $5,101,000 and net income of approximately $71,000 have been excluded from the combined results and have been reported as an adjustment to the July 1, 1991 consolidated retained earnings.

Management's Discussion and Analysis of Financial Condition and Results of Operations

Overview

The Company has experienced a significant increase in revenues over the past three fiscal years. The higher revenues have been largely produced by increases in the Company's subscriber base resulting from growth of the online services market and the expansion of its product offerings. The Company introduced a Macintosh version of America Online in fiscal 1989, a DOS version of America Online in late fiscal 1991 and a Windows version of America Online in the middle of fiscal 1993.

On August 19, 1994 the Company completed its merger with Redgate Communications Corporation ("RCC"), which became a wholly-owned subsidiary of the Company. The Company issued 894,650 shares of common stock for all the outstanding common and preferred stock and warrants of RCC. Additionally, 200,574 shares of the Company's common stock was reserved for outstanding stock options issued by RCC and being assumed by the Company. This transaction was accounted for as a pooling of interests. The accompanying consolidated financial statements of the Company have been restated to include the accounts of RCC for all periods presented.

The Company's online service revenues are generated from subscribers paying a monthly membership fee and hourly charges based on usage in excess of the number of hours of usage provided as part of the monthly fee. At September 1994 the Company's standard monthly membership fee, which includes five hours of service, was $9.95, with a $3.50 hourly fee for usage in excess of five hours per month. The Company has received revenues from time to time in the form of funding ("other revenues") for certain product development activities conducted by the Company on behalf of entities such as Apple Computer, Inc. ("Apple"). In December 1992 the Company entered into a seven year licensing and development agreement (with renewal provisions to extend the agreement through November 30, 2004) with Apple. Under the agreement, the Company granted Apple a non-exclusive license to use the America Online services platform to provide Apple-branded online services, and has agreed to provide development services to Apple on a fee for services basis. The Company will receive a royalty based on usage, with a total minimum royalty of $15 million over a five year period following the commercial launch of the Apple-branded online service. In addition to royalties, the Company received development funding leading up to the commercial launch of the Apple-branded online service. Apple commercially launched its branded online service, called e-World, in June 1994. A total of $1,548,000 and $2,957,000 of development funding has been recognized as other revenues in fiscal 1993 and fiscal 1994, respectively. The Company's other revenues are also generated from providing new media and interactive marketing services, including the aggregation and management of multimedia content databases, new media application development and outsourced marketing communications services.

Beginning in December 1993, demand for access to the Company's online services during times of peak loads (usually during the evenings) exceeded system capacity. This condition resulted in some customers having difficulty accessing the service as well as continued periodic problems in terms of service quality. The Company has been increasing system capacity through the addition of computer hardware and software, and has been working with its primary data communications carrier to increase network capacity to improve customer access to the America Online service. While system and network capacity have been added, and service quality has improved, customers calling in from certain areas of the country during peak times of service are occasionally experiencing difficulty accessing the service. The Company is continuing to add system capacity and working with its primary data communications carrier to add network capacity, and is improving service quality to meet the demands of its customers.

Results of Operations

Fiscal 1994 Compared to Fiscal 1993

Online Service Revenues For fiscal 1994, online service revenues increased from $38,462,000 to $100,993,000, or 163%, over fiscal 1993. This increase was primarily attributable to a 198% increase in revenues from IBM-compatible subscribers and a 145% increase in revenues from Macintosh subscribers as a result of a 230% increase in IBM-compatible subscribers and a 174% increase in Macintosh subscribers. The percentage increase in subscribers in fiscal 1994 was greater than the percentage increase in online service revenues due to the timing, during the year, of when subscribers were added. The majority of subscribers were added during the second half of the year, therefore there was not a full year impact on revenues. This was partially offset by an increase in average monthly net service revenue per subscriber, which increased from $14.20 in fiscal 1993 to $15.00 in fiscal 1994.

Other Revenues Other revenues, consisting of new media and interactive marketing services and funding from third parties, increased from $13,522,000 in fiscal 1993 to $14,729,000 in fiscal 1994.

Cost of Revenues Cost of revenues includes direct network-related costs, consisting primarily of data and voice communication costs, costs associated with operating the host computer system and providing customer support, royalties paid to information and service providers and production and other expenses related to marketing services. For fiscal 1994, cost of revenues increased from $28,820,000 to $69,043,000, or 140%, over fiscal 1993, and increased as a percentage of total revenues from 55.4% to 59.7%.

The increase in cost of revenues was primarily attributable to an increase in data communication costs, customer support costs and royalties paid to information and service providers. Data communication costs increased primarily as a result of the larger customer base and more usage by customers. Customer support costs, which include

personnel and telephone costs associated with providing customer support, were higher as a result of the larger customer base and a large number of new subscriber registrations. Royalties paid to information and service providers increased as a result of a larger customer base and more usage and the Company adding more service content to broaden the appeal of the America Online service.

The increase in cost of revenues as a percentage of total revenues is primarily attributable to data communication costs and is associated with (i) an increase in no-charge trial hours as a result of the high number of new subscriber registrations relative to the existing customer base; (ii) a higher percentage of usage during more costly daytime periods partially offset by more favorable pricing under an agreement with the Company's primary communications provider; and (iii) an increase in usage relative to net service revenues as a result of the introduction of a price change in May 1993. The increase attributable to data communications costs was partially offset by a decrease (as a percentage of total revenues) in production costs related to marketing services. The Company introduced a price change in the spring of 1993. Prior thereto, the Company's standard pricing was a monthly membership fee of $7.95 which included two hours of use each month, with five no-charge trial hours and no membership fee in the first month. Additional usage beyond that included with the membership was charged at $6.00 per hour. Effective May 1, 1993, the Company increased the monthly membership fee to $9.95 and increased the number of hours included to five per month. Additionally, the number of no-charge trial hours in the first month of membership was increased from five to ten. Effective July 1, 1993, the hourly fee for usage beyond that included with the membership was lowered to $3.50.

The Company is currently exploring options to minimize its data communication costs. Under consideration currently are (i) renegotiating more favorable rates with its primary data communication provider; (ii) contracting with alternate data communication providers; and (iii) acquiring the capability to control a data network. To the extent the Company builds its own data network, it would be required to make a substantial investment in telecommunications equipment, which the Company would expect to finance through leasing. This investment would be expected to be offset by the resulting cost savings for the Company.

Marketing Marketing expenses include the costs to acquire and retain subscribers and other general marketing expenses. For fiscal 1994, marketing expenses increased from $9,745,000 to $23,548,000, or 142%, over fiscal 1993, and increased as a percentage of total revenues from 18.7% to 20.3%. The increase in marketing expenses was primarily due to an increase in the number and size of marketing programs to expand the Company's America Online subscriber base. In addition, personnel costs were higher to support the number and size of marketing programs.

Product Development Product development costs include research and development expenses, other product development costs and the amortization of software costs. For fiscal 1994, product development costs increased from $2,913,000 to $4,961,000, or

70%, over fiscal 1993, and decreased as a percentage of total revenues from 5.6% to 4.3%. The increase in product development costs was attributable to an increase in personnel costs related to an increase in the number of employees. The decrease in product development costs as a percentage of total revenues was a result of the substantial growth in revenues for the year, which more than offset the additional product development costs. Product development costs, before capitalization and amortization, increased by 103% in fiscal 1994.

General and Administrative For fiscal 1994, general and administrative expenses increased from $8,581,000 to $13,562,000, or 58%, over fiscal 1993, and decreased as a percentage of total revenues from 16.5% to 11.7%. The increase in general and administrative costs was principally attributable to higher personnel, office and travel expenses related to an increase in the number of employees. The decrease in general and administrative costs as a percentage of total revenues was a result of the substantial growth in revenues for the year combined with the fixed nature of many of the general and administrative costs.

Other Income Other income consists primarily of investment income net of interest expense and rental income. For fiscal 1994, other income increased from $371,000 to $1,774,000. This increase was primarily attributable to an increase in interest income generated by higher levels of cash available for investment in fiscal 1994, as well as rental income received as a result of the purchase of the Company's office building, which was partially offset by interest expense on the loan obtained to purchase the building.

Income Taxes Income tax expense was $1,897,000 and $3,832,000 in fiscal 1993 and fiscal 1994, respectively. The income tax expense in fiscal 1993, with the exception of $764,000, was offset by the utilization of a net operating loss carryforward that has been reflected as an extraordinary item.

Fiscal 1993 Compared to Fiscal 1992

Online Service Revenues For fiscal 1993, online service revenues increased from $26,226,000 to $38,462,000, or 47%, over fiscal 1992. This increase was primarily attributable to a 65% increase in revenues from IBM-compatible subscribers and a 64% increase in revenues from Macintosh subscribers as a result of an 86% increase in IBM-compatible subscribers and a 70% increase in Macintosh subscribers. The percentage increase in subscribers in fiscal 1993 was greater than the percentage increase in online service revenues due to the timing, during the year, of when subscribers were added. The majority of subscribers were added during the second half of the year, therefore there was not a full year impact on revenues. The average monthly net service revenue per subscriber in fiscal 1993 was comparable to fiscal 1992.

The increase in online service revenues from IBM-compatible subscribers was primarily due to the Company's launch of the Windows version of America Online in January

1993. The decline in Commodore and Apple II subscribers and service revenues was a result of the continuing decrease in sales of Commodore and Apple II computers and the related decrease in the use of these computers.

Other Revenues Other revenues, which consist of new media and interactive marketing services and funding from third parties, increased from $12,527,000 in fiscal 1992 to $13,522,000 in fiscal 1993.

Cost of Revenues For fiscal 1993, cost of revenues increased from $20,852,000 to $28,820,000, or 38%, over fiscal 1992, and increased as a percentage of total revenues from 53.8% to 55.4%. The increase in cost of revenues was primarily attributable to an increase in data communication costs associated with (i) a higher percentage of usage during more costly daytime periods offset by more favorable pricing under an agreement with the Company's primary communications provider; (ii) an increase in trial offer hours as a result of the high number of registrations relative to the existing customer base; and (iii) an increase in usage relative to net service revenues as a result of the introduction of a price change in May 1993. In addition, personnel and telephone costs associated with providing customer support were higher to support the larger customer base.

The increase in cost of revenues as a percentage of total revenues is primarily attributable to an increase in data communication costs partially offset by a decrease (as a percentage of total revenues) in production costs related to marketing services.

Marketing For fiscal 1993, marketing expenses increased from $5,747,000 to $9,745,000, or 70%, over fiscal 1992, and increased as percentage of total revenues from 14.8% to 18.7%. The increase in marketing expenses was primarily due to an increase in the number of marketing programs to expand the Company's subscriber base. In addition, personnel costs were higher to support the increase in the number and size of marketing programs.

Effective July 1, 1992, the Company changed from twelve months to eighteen months the period over which it amortizes the cost of marketing acquisition costs in circumstance where the Company's starter kit is bundled with and distributed by a third-party. The Company retained a twelve month amortization period for subscriber acquisition costs in the case of independent direct marketing activities. The change in accounting estimate in the case of third party marketing efforts was made to more accurately match revenues and expenses. Based on the Company's experience and the distribution channels used in such marketing activities, there is a greater time lag between the time the Company incurs the cost for the starter kits and the time the starter kits begin to generate new subscribers than with direct marketing activities. Also, the period over which new subscribers (and related revenues) are generated is longer than that experienced with the use of traditional independent direct marketing activities. The effect of this change in accounting estimate for the year ended June 30, 1993, was to increase income before extraordinary item and net income by $264,000 ($.02 per share).

Product Development For fiscal 1993, product development costs increased from $2,015,000 to $2,913,000, or 45%, over fiscal 1992, and increased as a percentage of total revenues from 5.2% to 5.6%. The increase in product development costs was primarily attributable to an increase in personnel costs as well as higher amortization of software costs.

General and Administrative For fiscal 1993, general and administrative expenses increased from $6,454,000 to $8,581,000, or 33%, over fiscal 1992, and decreased as percentage of total revenues from 16.7% to 16.5%. The increase in general and administrative expenses was principally attributable to (i) an increase in costs associated with being a public company, including legal and other costs associated with the Company's adoption of a stockholder rights plan; (ii) expenses related to an increase in personnel to support the larger customer base as well as the Apple agreement; and (iii) travel expenses.

Other Income Other income consists principally of investment income net of interest expense. For fiscal 1993, other income increased to $371,000 from $113,000 in fiscal 1992. The increase in other income was primarily due to an increase in interest income generated by higher levels of cash available for investment in fiscal 1993.

Income Taxes Income tax expense was $1,454,000 and $1,897,000 in fiscal 1992 and fiscal 1993, respectively. The income tax expense in fiscal 1992, with the exception of $30,000 relating to alternative minimum tax, was fully offset by the utilization of a net operating loss carryforward that has been reflected as an extraordinary item. The income tax expense in fiscal 1993 was partially offset by the utilization of a net operating loss carryforward that has been reflected as an extraordinary item.

In fiscal 1993 the Company's remaining net operating loss carryforward for financial statement purposes was fully utilized.

Liquidity and Capital Resources

The Company has financed its operations through cash generated from operations, funding by third parties for certain product development activities and sale of its common stock. Cash flow from operating activities, including third party development funding, was $9,292,000, $12,890,000 and $39,308,000 for fiscal 1992, fiscal 1993 and fiscal 1994, respectively. Net cash used in investing activities was $7,402,000, $19,600,000 and $79,294,000 in fiscal 1992, fiscal 1993 and fiscal 1994, respectively. These investing activities included investments in subscriber acquisition costs of $5,567,000, $10,685,000 and $37,424,000 in fiscal 1992, fiscal 1993 and fiscal 1994, respectively.

In September 1991, the Company issued a new series of convertible preferred stock (which was converted into common stock in connection with the Company's initial public offering) for an aggregate purchase price of $5,000,000 to Tribune Company and at the same time entered into a co-marketing agreement with Tribune Company. In

March 1992, the Company completed its initial public offering which generated net cash proceeds of approximately $10,325,000, of which $3,199,000 was used to pay dividends on convertible redeemable preferred stock. In December 1993, the Company completed a public stock offering of 1,000,000 shares of common stock which generated net cash proceeds of approximately $62,700,000.

The Company uses its working capital to finance ongoing operations and to fund marketing programs and the development of its products and services. The Company plans to continue to invest aggressively in acquisition marketing programs to expand its subscriber base as well as in computing and support infrastructure. To the extent the Company builds its own data network, it would be required to make a substantial investment in telecommunications equipment, which the Company would expect to finance through leasing. The Company's investment in a data network would be expected to be offset by the resulting cost savings for the Company. Additionally, the Company expects to use a portion of its cash for the acquisition and subsequent funding of technologies, products or businesses complementary to the Company's current business (see Note 15 to the financial statements). The Company anticipates that available cash and cash provided by operating activities will be sufficient to fund its operations for the next fiscal year.

The Company believes that inflation has not had a material effect on its results of operations.

SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Dated: March 9, 1995

AMERICA ONLINE, INC.

By: LENNERT J. LEADER
Lennert J. Leader
Senior Vice President and Chief Financial Officer

INDEX TO EXHIBITS

Exhibit No.	Description	Page
23.1	Consent of Ernst & Young LLP	

CONSENT OF INDEPENDENT AUDITORS

We consent to the use of our report dated September 9, 1994, except for Note 14, as to which the date is November 25, 1994, included in Form 8-K filed by America Online, Inc. with respect to the restated consolidated financial statements, for the year ended June 30, 1994, reflecting the August 19, 1994 pooling of interests with Redgate Communications Corporation.

Ernst & Young LLP

Vienna, Virginia
March 8, 1995